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Message Text

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LIMDIS GREENBACK

USEEC ALSO FOR EMBASSY
USOECD ALSO FOR EMBASSY

E.O. 11652: GDS
TAGS: EFIN, UK
SUBJECT: HM TREASURY VIEWS ON EUROPEAN MONETARY SYSTEM

SUMMARY: HM TREASURY OFFICIAL WHO ATTENDED JULY 27-28 EC MONETARY COMMITTEE ALTERNATES MEETING AND WHO IS PREPARING BRIEF FOR THE ALTERNATES SESSION TO BE HELD LATER THIS WEEK REPORTS DISCUSSION TENDING TO SEPARATE INTO THREE MAIN AREAS: THE NUMERAIRE, WHERE THE GERMANS AND FRENCH HAVE DIFFERENT OPINIONS; INTERVENTION; AND THE ROLE OF THE EUROPEAN FUND. A PAPER ON TECHNICAL DETAILS HAS BEEN PREPARED FOR THIS WEEK'S MEETING TRYING TO OUTLINE THE MAIN POINTS AT ISSUE. OTHER MAJOR ITEMS DISCUSSED CONCERN RELATIONSHIP OF THE BREMEN PROPOSALS TO THE IMF, INCLUDING ARTICLE IV CONFIDENTIAL

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AND SDR; HOW GOLD WILL BE TREATED; AND CREDIT AND CONDITIONALITY WHICH SOME CONSIDER TO BE THE MAIN ISSUE THE RUN-UP OF MEETINGS UNTIL THE SEPTEMBER 18 FINANCE COUNCIL WILL PROBABLY IDENTIFY AND EXPLORE THE MAIN ISSUES INVOLVING THE NEED FOR POLITICAL COMPROMISE IF A NEW EC SYSTEM IS TO BE CONSTRUCTED. AT THIS POINT IN TIME, U.K. CONSIDERS IT UNLIKELY THAT ANY MAJOR

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COMPROMISESINNATIONAL POSITIONS WILL BE MADE BEFORE THE SEPTEMBER 18 FINANCE COUNCIL SESSIONS, WHEN THE ASSESSMENTS AND OPTIONS WILL BE OFFICIALLY PRESENTED TO MINISTERS FOR THE FIRST TIME. END SUMMARY.

1. NUMERAIRE: TREASURY REPRESENTATIVE HAD DISCUSSIONS WITH HM TREASURY OFFICIALS WHO ARE INVOLVED IN THE ONGOING WORK ON RESPONSE TO THE BREMEN PROPOSALS, INCLUDING PREPARATION FOR THIS WEEK'S EC MONETARY COMMITTEE ALTERNATES SESSIONS. ONE SOURCE REPORTS THAT THE JULY 27-28 MONETARY COMMITTEE ALTERNATES (BACQUIAST GROUP) SESSION WAS VERY POLITE AND COOPERATIVE, THE MAIN SUBSTANCE OF DISCUSSION CENTERING ON DIFFERENCES IN GERMAN AND FRENCH APPROACH ON THE NUMERAIRE. THE GERMANS IN EFFECT WISH TO CONTINUE OPERATING A SNAKE WITH THE CURRENCIES AT BOTH OUTER EDGES CONTINUINGTOINTERVENE IN EACH OTHER'S CURRENCY. THE FRENCH ARGUE FOR AN ECU IN WHICH, BECAUSE OF ITS WEIGHT, THE DM WOULD MOVE MORE HEAVILY THAN OTHER CURRENCIES.

2. U.K. SEES THIS DIFFERENCE AS EXTREMELY SIGNIFICANT. THE WEIGHTED ECU WOULD IDENTIFY THE ONE STRONGER OR THE ONE WEAKER CURRENCY IMMEDIATELY, UNLIKE THE SNAKE WHICH WOULD OPERATE AT BOTH EXTREMES. THE FRENCH APPARENTLY FEEL VERY STRONGLY ON THE NEED FOR AN ECU, CITING THE CONFIDENTIAL

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CIRCUMSTANCES WHICH FORCED THEM OUT OF THE SNAKE, WHICH THEY ATTRIBUTE TO THE IMPACT OF THE RISE IN THE DM AGAINST THE DOLLAR; THE GERMANS DID NOT INTERVENE AGAINST THE DOLLAR, WHICH PULLED UP THE FRENCH FRANC IN THE SNAKE AND EVENTUALLY FORCED THE FRENCH TO LEAVE IT.

3. SOURCE REMARKED THAT GISCARD AND SCHMIDT ARE OBVIOUSLY AT A CONSIDERABLE DISTANCE FROM THEIR ADVISORS. AT THE MOMENT, IT IS NOT CLEAR TO THE U.K. WHAT THE FULL AREAS OF FRENCH/GERMAN AGREEMENT OR DIS-AGREEMENT ARE ON PARTICULAR ISSUES. U.K. ASSUMES GISCARD MUST HAVE OPTED FIRMLY FOR THE ECU SYSTEM IN ORDER FOR BACQUIAST TOHAVE TAKEN THE POSITION HE DID. THE GERMANS, GIVEN THE SOMETIMES CONFLICTING POSITIONS OF THEIR MINISTERS IN A COALITION GOVERNMENT AND THE INDEPENDENT STRENGTH OF THE BUNDESBANK, ARE CONSIDERED LESS WELL-ORGANIZED THAN THE FRENCH IN PRESENTING THEIR POSITIONS. THIS SAID, THE MOOD OF THE MEETING WAS NOT ABRASIVE, DESPITE THE DISTANCE BETWEEN FRENCH AND GERMAN POSITIONS. SMALLERSNAKECOUNTRIES (HOLLAND, BELGIUM AND DENMARK) WERE ADAMANT THAT THEY WOULD NOT

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ABANDON THE SNAKE UNTIL ANOTHER EC SYSTEM WAS ACTUALLY SHOWN TO BE WORKING AFTER A TRIAL PERIOD.

4. INTERVENTION RULES: THE ECU SYSTEM BEING DISCUSSED DOES NOT YET MAKE PROVISION FOR WHICH CURRENCY ONE INTERVENES IN. RULES ARE NEEDED TO DETERMINE THE CURRENCIES WHICH WOULD BE BOUGHT TO HOLD DOWN ANOTHER (PRESUMABLY THE DM). THESE MOST LIKELY WOULD BE MAJOR CURRENCIES (FRENCH FRANC, LIRA, AND THE POUND) RATHER THAN THE SMALLER ONES WHICH WOULD BE MORE SHARPLY AFFECTED IN THE FOREIGN EXCHANGE MARKETS. NO DECISIONS WERE TAKEN, ALTHOUGH FOR INTERVENTION AGAINST THE STRONGEST CURRENCY,THE ALTERNATES MAY CONSIDER USING THE NEXT LARGEST CURRENCY ON THE LOWER SIDE OF ITS DECLARED CENTRAL RATE OR PIVOT. THE COMMUNITY HAS NO EXPERIENCE OPERATING SUCH A SYSTEM, DOESN'T FULLY UNDERSTAND THE TECHNIQUES INVOLVED, AND SOME OF THE MORE CONSERVATIVE CENTRAL BANKS APPEAR NERVOUS AS A
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RESULT.

5. RESERVE POOLING AND THE ROLE OF THE ECU AND EUROPEAN FUND: DISCUSSION ON THIS POINT WAS VERY UNCLEAR AND SOME OF THE PROPOSALS SEEM TO THE U.K. TO MAKE LITTLE SENSE. THE FRENCH ARE PRIMARILY BEHIND THE CREATION OF ECU BY DEPOSITING RESERVES. CENTRAL BANKS WOULD ONLY SETTLE IN ECU, WHICH LEAVES OPEN THE QUESTION OF WHAT HAPPENS WHEN A COUNTRY RUNS OUT OF THEM. MORE PRESUMABLY CAN BE OBTAINED BY FURTHER RESERVE DEPOSITS, BUT WHAT HAPPENS WHEN NATIONAL RESERVES RUN LOW. THE U.K.HAS QUESTIONED THE POINT OF HAVING THE ECU CREATED ON THIS BASIS WHEN USE OF NATIONAL RESERVES CAN ACHIEVE THE SAME ENDS.

6. THE SECOND CATEGORY OF ECU, THAT CREATED BY DEPOSIT OF NATIONAL CURRENCY IN ORDER TO PROVIDE CREDIT, IS ALSO CONSIDERED TO RAISE MORE UNANSWERED QUESTIONS THAN THERE ARE ANSWERS, AT LEAST THUS FAR. THERE WOULD BE NO RIGHT TO DRAW THESE FUNDS. SOME COUNTRIES HAVE ASKED IF IT IS A GOOD IDEA TO IN EFFECT ESTABLISH TWO DIFFERENT TYPES OF ECU WITHIN A COMPLICATED BALANCE SHEET STRUCTURE, WHEN IT MIGHT AS AN ALTERNATIVE BE POSSIBLE SIMPLY TO CREATE ECU ON THE COLLECTIVE GUARANTEES OF THE CENTRAL BANKS INVOLVED. THIS IS THE LEAST DEFINED OF THE THREE MAIN TOPICS, WITH A CLEAR, WORKABLE SCHEME STILL NOT IDENTIFIED.. U.K. AT THIS STAGE WOULD MAKE NO PREDICTIONS ON THE OUTCOME, WHICH PRESUMABLY WOULD REQUIRE LEGISLATION IF A FUND IS ENVISAGED; U.K. CONSIDERS IT HIGHLY DOUBTFUL THAT A CONSENSUS AND LEGISLATION COULD BE ACHIEVED ON THIS POINT BY JANUARY L, L979.

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7. OTHER MAIN POINTS DISCUSSED:

(A) THE RELATIONSHIP OF THE EC SYSTEM TO ARTICLE IV OF THEIMFNEED NOT BE INCONSISTENT WITH THAT ARTICLE'S AIMS AND INTENTIONS, BUT EVENTUALLY IT MAY BE NECESSARY FOR THE ENTIRE EC TO HAVE CONSULTATIONS WITH THE IMF,RATHER, THAN BY INDIVIDUAL COUNTRIES. BOTH THE EC AND DE LA ROSIERE ARE CONSIDERING THE POSSIBILITIES, BUT THUS FAR ARE A BIT BAFFLED.

(B) THE RELATIONSHIP BETWEEN ECU CREATION AND THE SDR. IT NEED NOT NECESSARILY WEAKEN THE SDR'S ROLE,

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ALTHOUGH DENOMINATION OF 20 PERCENT OF EC RESERVES IN ECU DOES BRING ANOTHER PLAYER ONTO THE SCENE.

(C) GOLD. GOLD RESERVES DEPOSITED TO OBTAIN ECU WILL BE AT MARKET-RELATED PRICES RATHER THAN AT AN OFFICIAL PRICE. THIS IS CONSIDERED "NOT PARTICULARL RE-MONETARISING GOLD". NO PRECISE PROPOSAL HAS BEEN MADE, ALTHOUGH PARTICIPANTS AGREE THAT THE PRICE DECIDED UPON "MUST OBVIOUSLY BE MARKET RELATED AND THIS WILL BE OKAY WITH THE IMF, WON'T IT?" SOURCE ALSO WONDERED ABOUT U.S. REACTION.

(D) CREDIT AND CONDITIONALITY, WHICH ONE SOURCE CONSIDERED THE MAIN ISSUE. EC HAS IMPOSED CONDITIONALIT IN THE PAST BUT WHAT IS UNDER CONSIDERATION IS MUCH MOR ELABORATE. SHOULD IT BE THE SAME OR DIFFERENT FROM THA IMPOSED BY THE IMF? IF DIFFERENT, THERE WILL BE A NEED TO JUSTIFY IT. IF TOUGHER THAN IMF CONDITIONALITY, NO ONE WILL WANT TO USE IT IF OTHER FINANCING SOURCES ARE AVAILABLE; IF WEAKER, LDC'S WOULD CERTAINLY HAVE SOME-THING TO SAY ABOUT IT. THERE IS A DILEMMA HERE.

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(E) SOURCE STRESSED THAT AS YET THERE ARE NO NATIONAL POSITIONS ON THE ABOVE POINTS. PARTICIPANTS ARE JUST BEGINNING TO THINK ABOUT THEM AND THEIR PRACTICAL IMPORTANCE.

8. IN REPLY TO QUESTION, SOURCE SAID MONETARY COMMITTE ALTERNATES DID NOT DISCUSS THE CAP. THE REAL POLITICAL OBSTACLE TO CHANGES IN THE CAP IS VIEWED AS GERMAN RATHER THAN FRENCH. THE SITUATION IS MUCH MORE COMPLEX THAN SIMPLY DIFFERENCES BETWEEN COUNTRIES; TENSIONS EXIST WITHIN INDIVIDUAL COUNTRIES BETWEEN THE FINANCE MINISTRIESANDMINISTRIES OF AGRICULTURE. AT BREMEN THE MAIN EFFORT TO CHANGE THE CAP CAME FROM THE ITALIAN RATHER THAN FROM THE U.K., ALTHOUGH THE U.K., INCLUDING THE GENERAL PUBLIC, IS FAIRLY WELL FED UP WITH A CAP WHICH CREATES AGRICULTURAL SURPLUSSES.

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9. LOOKING AHEAD, SOURCE EXPECTED THAT THE MANY EC COMMITTEES MEETING ON THE GENERAL SUBJECT BY MID-SEPTEMBER WOULD HAVE BROKEN THE BACK OFTHE PROBLEMS, IDENTIFIED THE ISSUES AND IDENTIFIED POSSIBLE AREAS OF AGREEMENT. HE SAID THUS FAR NO ONE IS SPEAKING OF A POOLING OF RESERVES IN ATRUEPOOLING SENSE NOR OF CENTRAL INTERVENTION IN A COORDINATED WAY FROM A SINGLE DECISION MAKING CENTER. THE FRENCH SEEM DETERMINED FOR POLITICAL REASONS TO HAVE A NEW SYSTEM, I.E. ONE DIFFERENT FROM THE SNAKE. THE U.K. DOUBTS THERE WILL BE ANY SIGNIFICANT COMPROMISES MADE UNTIL THE MAIN ISSUES HAVE BEEN IDENTIFIED AND REVIEWED BY MINISTERS AT LEAST TWICE. THE FIRST MINISTERIAL REVIEW WILL COME AT THE EC FINANCE COUNCIL ON SEPTEMBER 18.

10. IF THE NEXT ELECTION IS HELD IN OCTOBER, ONE SOURC SPECULATED THE CHANCELLOR MIGHT GIVE LESS THAN HIS FULL ATTENTION FROM MID-SEPTEMBER ONWARDS TO THE EC FINANCE COUNCIL, THE COMMONWEALTH FINANCE MINISTERS, AND THE IMF; IN THIS CASE, U.K. CAREER OFFICIALS WOULD PLAY A MORE SIGNIFICANT ROLE REPRESENTING HMG AT THESE SESSIONS

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